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No. 237

In the Supreme Court of the United States

OCTOBER TERM, 1940

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

EDITH LE GIERSE AND BANKERS TRUST COMPANY, AS EXECUTORS OF THE ESTATE OF CECILE LE GIERSE, DECEASED

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 9–17) is reported in 39 B. T. A. 1134. The opinion of the Circuit Court of Appeals (R. 40–42) is reported in 110 F. (2d) 734.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 13, 1940 (R. 43). The petition for a writ of certiorari was filed July 12, 1940,

and was granted October 14, 1940 (R. 43). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The decedent at 80 years of age was uninsurable. However, in conjunction with her purchase of an annuity, there was issued to her a so-called single premium life-insurance policy. The effect of the combined annuity and insurance policies was to eliminate the risk inherent in life insurance on the part of the insurance company and to provide decedent's beneficiary with no protection against loss resulting from death.

The question presented is whether, in these circumstances, the proceeds of the so-called insurance policy constituted an amount receivable "as insurance" within the meaning of Section 302 (g) of the Revenue Act of 1926, thereby enabling the decedent's estate to claim the special $40,000 estate tax exemption applicable to insurance.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutory provisions and Regulations will be found in the Appendix, *infra*, pp. 26–33.

STATEMENT

The facts, as found by the Board of Tax Appeals (R. 9–16), may be summarized as follows:

Cecile Le Gierse, a resident of New York, died of paralysis or cerebral apoplexy on January 1, 1936, at 80 years of age. She had suffered from chronic arthritis for eight or ten years but her condition had never reached an acute stage (R. 10).

On December 6, 1935, less than one month prior to her death, decedent entered into an agreement with the Connecticut General Life Insurance Company of Hartford, Connecticut, pursuant to which the company issued to her two "policies." One was an annuity contract in standard form, and the other was a so-called "Single Premium Life Policy—Non Participating", also in standard form, containing the usual provisions for cash surrender, optional modes of settlement at maturity, etc. (R. 11–13). *The insurance company would not have issued the insurance policy without the annuity, considering the age of the decedent.* It would have issued the annuity contract without the insurance policy. (R. 14.) No physical examination was taken by the decedent, and she was not required in her application for insurance to answer the additional questions which must normally be answered when the applicant is a woman (R. 13).

The annuity contract provided for payments to the decedent of $49.15 a month, or $589.80 a year; the life-insurance policy provided for the payment

of $25,000 to the decedent's daughter upon the decedent's death. For the two policies the decedent paid the insurance company in advance the sum of $27,125; of this amount, $4,179 represented the premium for the annuity contract and $22,946 represented the premium for the "insurance" policy. The annuity payments which the insurance company agreed to make to the decedent amounted only to slightly more than 2 percent of the aggregate amount paid by the decedent to the company and was less than what the company realized on that amount annually, less expenses, taxes, and other charges in connection with the policies. Similarly, the total amount to be paid by the company at decedent's death was less than the aggregate amount paid by the decedent to the company. Consequently, at the time of the issuance of the policies, it was apparent that upon decedent's death the company would pay out a maximum amount, including the annuity payments, of less than the aggregate premiums charged for both policies and the return received by the company on those premiums. (R. 11–12, 14–15, 21–22, 26.)

The principal reason given by the decedent for entering into the agreement with the insurance company was her desire to preserve the principal of her estate from further shrinkage; the estate tax situation did, however, come up in the discussion between the decedent and the life insurance agent. The decedent knew a great deal about

taxes and was getting practically no income from her investment in securities. One of the reasons for her action was to provide her daughter with cash to take care of estate taxes, but the primary factor was the conservation of the principal of her estate. (R. 13–14.)

The company treated the two contracts as separate and issued a separate receipt to the decedent for each. The company maintains separate reserves for insurance and annuities. The $22,946 premium paid for the life-insurance policy was credited to the insurance account and the $4,179 paid for the annuity was credited to the annuity account. The company is required to report to the state commissioner of insurance all insurance policies issued and canceled, and also all annuities issued and canceled; the two contracts were reported under the two groups, one under life insurance and the other under annuities. In computing the single premium paid for the life-insurance policy, no adjustment was made for the amount to be received as a premium for the annuity policy. Likewise, in computing the amount charged for the annuity policy, no adjustment was made for the single premium to be received on the insurance policy. (R. 14.)

The Commissioner determined that both policies were purchased as one transaction, that the proceeds of the life-insurance policy were not received "as insurance" within the meaning of Section

302 (g) of the Revenue Act of 1926, and that consequently decedent's estate was not entitled to the $40,000 insurance exemption provided by Section 302 (g). Treating the entire transaction as a transfer made to take effect at or after death within the meaning of Section 302 (c), of the 1926 Act, the Commissioner determined a deficiency of $3,875.29 (R. 10, 15–16). The Board of Tax Appeals reversed this determination, holding that the proceeds of the life-insurance policy were received "as insurance," and that the estate was therefore entitled to the exemption (R. 16–17). The Circuit Court of Appeals, although conceding that "the entire transaction is to be considered" (R. 42), affirmed the decision of the Board (R. 43).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding and deciding that the so-called single-premium life-insurance policy, issued in conjunction with the life annuity contract, is a life-insurance policy within the purview of Section 302 (g) of the taxing statute, as amended.

2. In holding and deciding that the so-called life-insurance policy, issued in conjunction with the life annuity contract, could be given effect as a life-insurance policy within the purview of the statute although it would not have been issued as a separate and independent contract.

3. In not holding and deciding that the disposition made by the decedent of the proceeds arising

out of the so-called life-insurance policy constituted a transfer in contemplation of or intended to take effect in possession or enjoyment at or after the decedent's death, within the purview of Section 302 (c).

4. In not holding that the so-called life-insurance policy was not an insurance policy upon the life of the decedent within the meaning of the statute.

5. In not reversing the decision of the Board of Tax Appeals and affirming the determination of the Commissioner of Internal Revenue.

6. In holding there was no deficiency in tax under the facts as adduced.

SUMMARY OF ARGUMENT

1. The decision of the court below represents the triumph of a paradox. The Board found, and respondents concede, that the decedent was uninsurable. Yet the court below concluded that the very company which considered the decedent uninsurable did in fact insure her, and did so without departing from its customary standards. This paradoxical result stems from a failure on the part of the court below to comprehend that the life-insurance policy issued to decedent was merely the form by which the parties carried out an agreement which in substance involved no insurance feature whatever.

Life insurance is, in essence, the shifting from the insured to the insurer of the risk of loss due to the insured's death before the end of his life expectancy. Decedent's agreement with the insurance company provided for no such shifting of risk. Decedent paid the company the sum of $27,125. In return, the company agreed to pay her $589.80 a year during her life (this being slightly more than 2 percent of $27,125), and to pay her daughter $25,000 upon her death. The only risks which decedent transferred to the insurance company were the risk that her principal of $27,125 might not bring her a return during life equal to $589.80 a year, and the risk that that principal might depreciate in value to less than $25,000 by the time she died; these risks are obviously investment risks and not the life insurance risk of death before the end of the insured's life expectancy. So far as the company's financial situation was concerned, the time of decedent's death was completely immaterial. Plainly, therefore, the agreement between the decedent and the company involved no life insurance feature whatever.

This conclusion, apparent from the face of the agreement, is also supported by extrinsic evidence. The Board found that the principal purpose of the decedent in entering into the agreement was to conserve the principal of her estate. This is not an

insurance but an investment purpose. Similarly, the company had no purpose to insure the decedent's life. It considered her uninsurable because of age—indeed, so completely uninsurable that a physical examination to determine the extent of the insurance risk was considered immaterial and was, therefore, not required. It would have refused to issue the life insurance policy to her had she not taken out the annuity policy in conjunction therewith. It is clear, therefore, that the company's purpose was not to insure the decedent's life but to make a profitable investment contract.

Since the agreement made by decedent with the company did not involve any insurance of her life, the insurance exemption provided by Section 302 (g) is not available to respondents simply because a life insurance policy was employed as the form in which part of the agreement was effectuated.

2. No insurance of decedent's life being involved, the transfer by the decedent to the insurance company is taxable under Section 302 (c) of the Revenue Act of 1926. This section requires the inclusion in decedent's gross estate of the value of all property to the extent of any interest therein of which the decedent at any time made a transfer, by trust or otherwise, intended to take effect in possession or enjoyment at decedent's death. The broad purpose of the provision is to tax "*inter vivos* transfers that are too much akin to testa-

mentary dispositions not to be subjected to the same excise." *Helvering* v. *Hallock*, 309 U. S. 106, 111–112. Here the record discloses an *inter vivos* transfer intended to pass property to the beneficiary at decedent's death—an arrangement wholly testamentary in character. To hold that such an arrangement does not fall within Section 302 (c) is to give effect to the form of the transaction while ignoring its substance.

ARGUMENT

I

DECEDENT'S AGREEMENT WITH THE INSURANCE COMPANY DID NOT CONSTITUTE A CONTRACT OF LIFE INSURANCE

Section 302 (g) of the Revenue Act of 1926, as amended (*infra*, pp. 26–27), provides for the inclusion in the gross estate of the decedent, for estate-tax purposes, of insurance proceeds—

> To the extent of the amount receivable by the executor *as insurance* under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries *as insurance* under policies taken out by the decedent upon his own life. [Italics supplied.]

The question here is whether the decedent's agreement with the insurance company, which involved no risk on the part of the company and provided the decedent's beneficiary no protection against loss resulting from death, nevertheless constituted

a contract of life insurance because it was carried out in part through the issuance of a life-insurance policy. The decision of the court below that the agreement did constitute such a contract is in direct conflict with the decisions of the Circuit Courts of Appeals for the Third and Eighth Circuits in *Commissioner* v. *Keller's Estate*, 113 F. (2d) 833 (C. C. A. 3d), and *Helvering* v. *Tyler*, 111 F. (2d) 422 (C. C. A. 8th).[1] Writs of certiorari have been granted in these two cases (Nos. 368 and 371, respectively) and the *Keller* case is to be argued

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[1] The decision below is also in substantial conflict with *Old Colony Trust Co.* v. *Commissioner*, 102 F. (2d) 380 (C. C. A. 1st). In that case the entire agreement between the decedent and the insurance company was embodied in a single policy; the Circuit Court of Appeals for the First Circuit held that no insurance exemption was available because the annuity feature of the policy predominated and gave the agreement the character of an investment rather than of an insurance contract.

The state courts in many cases have also indicated a view at variance with that of the court below, although the situation presented in those cases was not precisely the same as that presented here. See *State ex rel. Thornton* v. *Probate Court*, 186 Minn. 351; *People ex rel. Metropolitan Life Ins. Co.* v. *Knapp*, 184 N. Y. S. 345; *Commonwealth* v. *Metropolitan Life Ins. Co.*, 254 Pa. 510, 514; *Urwan v. Northwestern Nat. Life Ins. Co.*, 125 Wis. 349; *Schreiber* v. *German-American Hail Ins. Co.*, 43 Minn. 367; *Timlin* v. *Equitable Life Assurance Society*, 141 Wis. 276; *Welch* v. *Union Cent. Life Ins. Co.*, 108 Iowa 224; *Mutual Life Ins. Co.* v. *New*, 125 La. 41.

The result reached by the court below has been disapproved by several of the leading law reviews. Note (1940) 40 Col. L. Rev. 86; Note (1940) 49 Yale L. J. 946; Note (1940) 38 Mich. L. Rev. 526. See also Paul, *Studies in Federal Taxation* (3rd Series), 374–386, 388–391.

immediately following the present case. Counsel have stipulated that the disposition of the *Tyler* case is to be governed by the decision in the present case.

The decision of the court below represents the triumph of a paradox. The Board found, and respondents concede, that the decedent was uninsurable. Yet the court below concluded that the very company which considered the decedent uninsurable did in fact insure her and did so without departing from its customary standards.

In our view, this paradoxical result stems from a failure on the part of the court below to comprehend that the life-insurance policy issued to decedent was merely the *form* by which the parties carried out an agreement which *in substance* involved no insurance feature whatever. This will become clear upon analysis of the essential elements of an insurance contract and upon comparison of such a contract with the agreement here involved.

There is a substantial unanimity of authority among both courts and commentators as to the fundamental nature of insurance. The purpose of insurance is to furnish protection against loss from a defined risk by having the losses of the unfortunate few paid by contributions of the many who are exposed to the same risk. The insurance company is the medium through which this end is accomplished. The individual transfers the bur-

den of risk to the company; the company, through the issuance of a large number of policies to other individuals facing the same risk, in effect distributes the risk of each among the whole group. The practical result is to associate all the policyholders in an agreement that all will share the loss of each.

In the case of life insurance, the risk insured against is that of premature death—i. e., death before the end of the insured's life expectancy. In the event of such premature death, the loss to the insured's beneficiaries is borne by the insurance company, which must pay out to the beneficiaries a larger sum than the value of the insured's payments to it. The loss to the insurance company is, in turn, made up by the contributions of those who outlive their life expectancies and who, therefore, pay for protection against a risk of loss which has not materialized.

It is apparent, therefore, that there are at least three essential elements in every insurance contract: (1) the contract must provide for the shifting of a risk from the insured to the insurer; (2) from the standpoint of the insured, the contract must provide protection against loss in the event that the contingency insured against occurs; and (3) from the standpoint of the insurer, the risk assumed must be consolidated with other similar risks, so that the losses which occur may be paid through the contributions of those who do not suffer loss.

A few of the many authorities supporting the foregoing analysis are cited in the margin.[2] Typical of the statements made in these authorities are the following:

> It is the fundamental purpose of life insurance to furnish protection through the operation of the insurance function against the financial needs occasioned by death, old age, or disability. Through the agency of insurance the burden of risk is transferred from the shoulders of the individual to whom it is attached to a carrier willing to assume it. The end is accomplished by associating a large number of individuals exposed to the risk in question by means of an agreement that the entire group shall share the losses of individuals. [Magee, *Life Insurance*, p. 1.]
>
> From what has been said it is evident that *the primary requisite essential to the existence of every contract of insurance is the presence of a risk of loss.* The insurer, in

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[2] Cooley, *Briefs on the Law of Insurance*, Vol. I, p. 80; Huebner, *Life Insurance*, pp. 4, 10, 19–20; Vance, *Handbook of the Law of Insurance*, pp. 3–5; Magee, *Life Insurance*, p. 1; Manes, *Insurance: Principles and History*, 8 Encyc. Soc. Science (1932), p. 95; Mowbray, *Insurance, Its Theory and practice in the United States*, pp. 1, 26, 150; (1939) 52 Harv. L. Rev. 1180; Note (1940) 38 Mich. L. Rev. 526; Note (1937) 32 Ill. L. Rev. 223, 233; Note (1936), 36 Col. L. Rev. 456; Notes, 63 A. L. R. 711, 100 A. L. R. 1449; *Ritter* v. *Mutual Life Ins. Co.*, 169 U. S. 139, 151–152; *Old Colony Trust Co.* v. *Commissioner*, 102 F. (2d) 380 (C. C. A. 1st); *Home Title Ins. Co.* v. *United States*, 50 F. (2d) 107 (C. C. A. 2d), affirmed, 285 U. S. 191; *Commonwealth* v. *Equitable Beneficial Ass'n*, 137 Pa. 412, 419.

> return for a consideration paid to him by the insured, assumes this risk, and wherever such risk exists and is assumed by one of the parties to the contract, whatever form a contract may take, it is in fact a contract of insurance. Risk is essentially the subject of the contract. *If there be no risk there can be no contract, and until the risk commences the contract does not attach.* (*Hart* v. *Delaware Ins. Co.*, 11 Fed. Case 683.) [Italics supplied.] [Cooley, *Briefs on the Law of Insurance*, Vol. I, p. 80.]
>
> To grant indemnity or security against loss, for a consideration, is not only the design and purpose of an insurance company, but is also the dominant and characteristic feature of the contract of insurance. [*Commonwealth* v. *Equitable Beneficial Ass'n*, 137 Pa. 412, 419.]

Decedent's agreement with the insurance company involved none of these essential elements of insurance. There was no shifting of risk, there was no protection against loss resulting from death before the end of the insured's life expectancy, and, since the insurance company assumed no risk, it obviously did not perform the essential insurance function of consolidating risks.

The absence of insurance risk in the agreement is plain. Decedent paid the insurance company the sum of $27,125. In return, the company agreed to pay her $589.80 a year during her life (this being slightly more than 2 percent of $27,125), and to pay her daughter $25,000 upon her

death. The only risks which the decedent transferred to the insurance company were the risks that her principal of $27,125 might not bring her a return during life equal to $589.80 a year, and the risk that that principal might depreciate in value to less than $25,000 by the time she died; these risks are obviously investment risks and not the life insurance risk of death before the end of the insured's life expectancy. Conversely, these investment risks were the only risks assumed by the insurance company; apart from the possibility of a shrinkage in value in principal and a return on capital of less than 2 percent, the company incurred no risk of loss and its financial situation could not be affected by the time of decedent's death.[3]

[3] Respondents contended in their brief in the court below (p. 14) that the company might have sustained a loss if the decedent had lived and at the end of the first year had surrendered the insurance policy for its cash surrender value, which would then have been $19,515. The contention is without merit. Had the contingency suggested occurred, the insurance company would have received premiums of $7,577 in excess of the amount paid out as the cash surrender value of the insurance policy, and its only obligation would have been to pay the decedent $589.80 a year during her life. Assuming that the company realized only a 3 percent return on its capital, the decedent would have had to live 16½ years, or until the age of over 96, before the company suffered any loss. Decedent's life expectancy at the time of the issuance of the policies was about four or five years (R. 15).

Furthermore, even if the company did undertake a remote risk of loss in this situation, the risk would spring from the annuity rather than from the insurance feature of the agreement. Consequently, the existence of the risk, if any, would not show that decedent's life was insured.

Plainly, therefore, the agreement made between the decedent and the company was not designed to insure the life of the decedent, i. e., to protect against the risk of loss due to decedent's death before the end of her life expectancy.

This conclusion, apparent from the face of the agreement, is also supported by extrinsic evidence. The Board found, and the record conclusively establishes, that the principal purpose of the decedent in entering into the agreement was to conserve the principal of her estate. This, of course, is not an insurance but an investment purpose. The company, too, had no purpose to insure the decedent's life. It considered her uninsurable because of age—indeed, so completely uninsurable that a physical examination to determine the extent of the insurance risk was considered immaterial and was, therefore, not required. It would have refused to issue the life-insurance policy to her had she not taken out the annuity policy in conjunction therewith. It is clear, therefore, that the company's purpose was not to insure the decedent's life but to make a profitable investment contract.

Had the parties called in a scrivener to draft a simple contract embodying the principal features of their agreement, that contract would have provided merely for the transfer of $27,125 by the decedent to the company, in return for which the company agreed to pay the decedent $589.80 each

year during her life and, upon her death, to pay her daughter $25,000. The contract would not have had any resemblance to a life-insurance policy and it is obvious that no court would have held it to be a contract of insurance.

It can make no difference for purposes of the present case that, instead of drafting such a contract, the agreement was executed by the issuance of two standard policies, one an annuity and the other a life insurance policy. The character of these standard policies is such that, taken together, they achieve the same result as would have been achieved by the simple contract described. The standard annuity form provides for fixed payments during the annuitant's life; the standard life insurance form provides for the payment of a fixed sum at the death of the insured. When issued in conjunction, they perform the function neither of an annuity nor of an insurance contract, but instead serve to effectuate simply the type of investment contract above described.[4]

The explanation of the apparent phenomenon whereby the issuance of a standard life-insurance

[4] The true nature of the transaction cannot be obscured by the fact that the printed forms of insurance and annuity contracts which were used contain the usual options, privileges, restrictions, etc., which are always found in such contracts. The existence of these provisions does not in any way militate against the conclusion that the contract forms employed were merely a device to effectuate a transaction unrelated to the actual insurance of decedent's life. See *Helvering* v. *Tyler*, 111 F. (2d) 422, 426 (C. C. A. 8th).

policy serves to effectuate an investment contract involving no insurance lies in the fact that an annuity policy is the reverse of a life-insurance policy and that, when placed in juxtaposition, they serve to counteract one another economically. See Harwood and Francis, *Insurance and Annuities from the Buyer's Point of View* (9th ed, 1938), p. 120; Note (1940) 49 Yale L. J. 946, 952; Note (1940) 38 Mich. L. Rev. 526, 528; *Carroll* v. *Equitable Life Assur. Soc.*, 9 F. Supp. 223 (W. D. Mo.); *In re Walsh*, 19 F. Supp. 567 (D. Minn.). An annuity policy is advantageous to the policyholder and disadvantageous to the company if the annuitant outlives his life expectancy; the exact converse is true of life insurance. Consequently, when both types of policies are issued in conjunction, all risk of loss arising from the time of decedent's death disappears. The obligation to pay the annuity continues only so long as the annuitant lives; during this time, the insurance company is under no obligation to pay out the face amount of the life-insurance policy. As soon as the annuitant dies, obliging the company to pay out the face amount of the insurance policy, the obligation to pay the annuity ceases. It follows that in every case where the aggregate amount paid for the annuity and insurance policies equals or exceeds the face amount of the insurance policy, and where the return on that amount to the insurance company equals or exceeds the annual annuity payments,

there is no shifting of any risk of loss and consequently no element of insurance.

The issue here, then, comes down to the question whether Section 302 (g) grants an exemption in the case of all amounts payable in the form of proceeds under a life-insurance policy, even though that policy is merely a device to effectuate an investment contract involving no insurance feature, or whether it grants an exemption only where actual insurance of the decedent's life is involved. In our view, the intent of Congress was plainly to grant the exemption only in the latter situation. The purpose of the exemption was to encourage the institution of life insurance as "the least costly and most equitable device yet evolved to preserve families in a wage-earning society from destitution." See *Commissioner* v. *Keller's Estate,* 113 F. (2d) 833, 835 (C. C. A. 3d). It was the economic function, and not the formal appearance, of life insurance which Congress desired to promote. Effectuation of its purpose requires, therefore, that the exemption be granted only where decedent's life was actually insured.

This conclusion follows, too, from application of the well-established principle that in tax matters substance rather than form controls. *Weiss* v. *Stearn,* 265 U. S. 242, 254; *United States* v. *Phellis,* 257 U. S. 156, 171, 172; *Gregory* v. *Helvering,* 293 U. S. 465, 469–470; *Helvering* v. *Bashford,* 302 U. S. 454, 458; *Minnesota Tea Co.* v. *Helvering,*

302 U. S. 609, 613–614; *Griffiths* v. *Commissioner,* 308 U. S. 355, 357–358; *Higgins* v. *Smith,* 308 U. S. 473. It would be a clear violation of this principle to grant an exemption simply because an amount is payable in the form of proceeds under a life-insurance policy, where, as here, the policy is, in effect, simply a device to carry out an agreement having no life-insurance feature whatever.

The contrary result reached by the court below is based on the fundamentally erroneous assumption that "the undertakings of the insurance company were obviously intended to be separable and independent" because a "separate application was made for each policy, a separate consideration paid for each, neither policy made reference to the other, and either could have been assigned, and the life policy could have been surrendered, without affecting the insurance company's obligations under the other" (R. 42). We fail to understand how the court below could have concluded that the undertakings of the company were separable and independent when the Board found, and the respondents concede, that the decedent was uninsurable and that the life-insurance policy would not have been issued to her without the annuity. This fact clearly establishes the interdependence of the two undertakings; it makes irrelevant the formal separation of the undertaking into two apparently independent documents, the filing of separate applications and the issuance of separate receipts for each, and the separate treatment of the two policies

by the company for purposes of its reserves and reports. The effective fact is that the company joined the insurance and the annuity features of its agreement with the decedent by refusing to write the insurance without the annuity; the company having insisted that both contracts be made as part of a single agreement, the courts cannot properly treat the contracts as separable for tax purposes.

It is, of course, beyond dispute that separate contracts which form parts of a single transaction must be construed together for tax purposes. The situation is comparable to that presented in cases where a series of different steps is taken in accordance with a preconceived plan to carry out what is essentially a single transaction. Although each step, separately considered, may be effective to create legal rights and obligations as between the parties thereto, it is firmly established that the transaction may not be split up into its component parts for tax purposes. *Pearson* v. *McGraw,* 308 U. S. 313; *Minnesota Tea Co.* v. *Helvering,* 302 U. S. 609; *Helvering* v. *Bashford,* 302 U. S. 454, 458.[5]

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[5] See also: *Starr* v. *Commissioner*, 82 F. (2d) 964 (C. C. A. 4th) certiorari denied, 298 U. S. 680; *Helvering* v. *Elkhorn Coal Co.*, 95 F. (2d) 732 (C. C. A. 4th); *Bassick* v. *Commissioner*, 85 F. (2d) 8 (C. C. A. 2d); *Hendee* v. *Commissioner*, 98 F. (2d) 934 (C. C. A. 7th); *Prairie Oil & Gas Co.* v. *Motter*, 66 F. (2d) 309 (C. C. A. 10th); *Ahles Realty Corp.* v. *Commissioner*, 71 F. (2d) 150 (C. C. A. 2d); *Commissioner* v. *Schumacher Wall Bd. Corp.*, 93 F. (2d) 79 (C. C. A. 9th); *United States* v. *Rodgers*, 94 F. (2d) 666 (C. C. A. 3d); *Miller* v. *Commissioner*, 103 F. (2d) 58 (C. C. A. 6th).

We submit, therefore, that decedent's agreement with the insurance company must be considered in its entirety, that so considered no insurance whatever was involved, and that therefore the insurance exemption provided for in Section 302 (g) is not available to the respondents.[6]

II

THE TRANSFER BY THE DECEDENT TO THE INSURANCE COMPANY IS TAXABLE UNDER SECTION 302 (C) OF THE REVENUE ACT OF 1926

Since decedent's agreement with the insurance company did not involve insurance, it seems clear that the value of the proceeds payable to the beneficiary must be included in decedent's gross estate under Section 302 (c) of the 1926 Act (*infra*, pp. 26–27). This section requires the inclusion in decedent's gross estate of the value of all property to the extent of any interest therein of which the decedent at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at decedent's death. The section further provides that any transfer of a material part of decedent's property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without full consideration, shall,

[6] The general rule that provisions of the Revenue Acts granting exemptions or other favored treatment are to be strictly construed is, of course, applicable. See, *e. g.*, *United States* v. *Stewart*, No. 13, present Term; *Helvering* v. *Northwest Steel Rolling Mills, Inc.*, No. 121, present Term.

unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of the statute. The taxable event is the *inter vivos* transfer by the decedent; the measure of the tax is the value of the property received upon decedent's death. See *Helvering* v. *Hallock,* 309 U. S. 106, 111.

Decedent's agreement with the insurance company plainly involved a transfer by her of a sum of money which decedent contemplated would, upon her death, result in the delivery to her daughter of $25,000. The primary purpose of decedent was to keep her remaining capital undiminished and, upon her death, to pass it intact to her daughter (R. 13, 27). This purpose was fully accomplished in the arrangement with the insurance company; as we have pointed out, the agreement between the parties in effect provided for a stipulated monthly payment to the decedent for life and a payment of $25,000 to decedent's daughter upon decedent's death. Such an agreement, which is comparable in effect to a transfer in trust with a life interest reserved, clearly comes within the language and spirit of Section 302 (c). It is immaterial that the transfer did not involve "the passing of particular items of property directly from the decedent to the transferee"; it is enough that there was a "transfer of property procured through expenditures by the decedent with the purpose, effective at his death, of having it pass to another." *Chase National Bank* v. *United States,* 278 U. S. 327, 337. A contrary

holding would open wide the door to tax avoidance, even without the use of the life insurance form.

This Court recently had occasion to consider Section 302 (c) and in its decision recognized that the broad purpose of the provision is to tax "*inter vivos* transfers that are too much akin to testamentary dispositions not to be subjected to the same excise." *Helvering* v. *Hallock,* 309 U. S. 106, 111–112; see also *Klein* v. *United States,* 283 U. S. 231. Here the record discloses an *inter vivos* transfer intended to pass property to the beneficiary at decedent's death—an arrangement wholly testamentary in character. To hold that such an arrangement does not fall within Section 302 (c) is to give effect to the form of the transaction while ignoring its substance.

CONCLUSION

The decision of the court below should be reversed.

Respectfully submitted.

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NOVEMBER 1940.

APPENDIX

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 803 (a) of the Revenue Act of 1932, c. 209, 47 Stat. 169, and by Sections 401 and 404 of the Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside the United States—
>
> (a) To the extent of the interest therein of the decedent at the time of his death;
>
> * * * * *
>
> (c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom;

except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title.

(d) (1) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth.

* * * * *

(g) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life.

* * * * *

[U. S. C., Title 26, Sec. 411.]

Treasury Regulations 80 (1937 ed.):

ART. 13. PROPERTY OF DECEDENT AT TIME OF DEATH.—It is designed by the foregoing provision of the statute that there shall be included in the gross estate all property of the decedent, whether real or personal, tangible or intangible, the beneficial ownership of

which was in the decedent at the time of his death, except real property situated outside the United States.

* * * * * *

ART. 18. TRANSFERS WITH POSSESSION OR ENJOYMENT RETAINED.—(a) *Transfers included.*—The statutory phrase, "a transfer * * * intended to take effect in possession or enjoyment at or after his death," includes a transfer, whether in trust or otherwise, made subject to the reservation or retention by the decedent of the use, or the possession, or the rents or other income or enjoyment of the transferred property, or any part thereof, for his life, or for a period not ascertainable without reference to his death, or for such a period as to evidence his intention that it should extend at least for the duration of his life; including also the reservation or retention of the use, possession, rents, or other income the actual enjoyment of which, by the decedent, was to be postponed until the termination of a transferred precedent interest or estate. (See article 15.)

If for any such period the use, possession, rents, or other income (in whole or in part) were to be disposed of in discharge of a legal obligation of the decedent or otherwise for his pecuniary benefit, then to that extent the use, possession, rents, or other income will be treated as having been reserved to or retained by the decedent.

(b) *Taxability.*—Every such transfer (not amounting to a bona fide sale for an adequate and full consideration in money or money's worth), made by the decedent subsequent to September 8, 1916, is taxable, and the value of the property or interest so transferred shall be included in the gross

estate of the decedent. The provisions of this subdivision do not apply (1) if the transfer was made prior to 10:30 p. m., eastern standard time, March 3, 1931, and (2) if the decedent died prior to 5 p. m. eastern standard time, June 6, 1932. See section 506 of the Revenue Act of 1934.

ART. 19. TRANSFERS WITH RIGHT RETAINED TO DESIGNATE WHO SHALL POSSESS OR ENJOY.—

(a) *Transfers included.*—The statutory phrase, "a transfer * * * intended to take effect in possession or enjoyment at or after his death," includes a transfer, by trust or otherwise, in connection with which the decedent reserved or retained, either to himself alone or in conjunction with any other person or persons, the right during his life, or for a period not ascertainable without reference to his death, or for such a period as to evidence an intention that the right should continue for at least the duration of his life, to designate the person or persons who should possess or enjoy the transferred property (in whole or in part), or any of the income thereof. (See article 15.)

(b) *Taxability.*—If the transfer was not a bona fide sale for an adequate and full consideration in money or money's worth, the property or the interest or interests therein so transferred shall be included in the gross estate if falling within any one of the following paragraphs:

* * * * *

(3) When the transfer was made and decedent died after the enactment of the Revenue Act of 1932 (5 p. m. eastern standard time, June 6, 1932) and the right to so designate was reserved at the time of the transfer, whether exercisable by decedent

alone or in conjunction with a person or persons having or not having a substantial adverse interest or interests in the transferred property, or in conjunction with persons one or more of whom had and one or more of whom had not such an adverse interest.

As used in this article, the expression "reserved at the time of the transfer" includes any understanding, expressed or implied, had in connection with the making of the transfer that the right to designate the person or persons who should possess or enjoy the property or the income therefrom should later be created or conferred.

ART. 20. TRANSFERS WITH POWER TO CHANGE THE ENJOYMENT—(a) *Transfers included.*—Subdivision (d) of section 302 of the Revenue Act of 1926, as amended, embraces a transfer by trust or otherwise (if not amounting to a bona fide sale for an adequate and full consideration in money or money's worth) when at the time of decedent's death the enjoyment of the transferred property, or some part thereof or interest therein, was subject to any change through a power exercisable either by the decedent alone, or by him in conjunction with some other person or persons, to alter, or amend, or revoke, or terminate. (See article 15.)

* * * * *

(b) *Taxability.*—The property or the interest or interests therein so transferred shall be included in the gross estate if coming within any one of the following paragraphs:

(1) Regardless of when the transfer was made, if the decedent died after the enactment of the Revenue Act of 1916 (September 8, 1916), and the power was reserved at the time of the transfer and was exercisable by the decedent alone or in conjunction with

a person or persons having no substantial adverse interest or interests in the transferred property, or if exercisable in conjunction with a person having a substantial adverse interest or with several persons some or all of whom held such an adverse interest, then to the extent of any interest or interests held by a person or persons not required to join in the exercise of the power and any adverse interest which was not substantial.

(2) When the transfer was made after the enactment of the Revenue Act of 1924 (4:01 p. m., eastern standard time, June 2, 1924) and before the amendment of the subdivision by the Revenue Act of 1936 became effective (June 23, 1936), and the decedent's death occurred at any time subsequent to the transfer, and the power was reserved at the time of the transfer and was exercisable by the decedent alone or in conjunction with a person or persons either having or not having a substantial adverse interest or interests in the transferred property, or in conjunction with persons one or more of whom had and one or more of whom had not such an adverse interest.

* * * * * *

As used in this and in the next succeeding article, the expression "reserved at the time of the transfer" refers to a power which, having been reserved when the transfer was made, continued to the date of decedent's death (see the paragraph next following as to the conditions under which the power will be considered as existent at decedent's death) to be exercisable by decedent alone or by him in conjunction with some other person or persons, and includes any understanding, expressed or implied, had in connection with the making of the transfer

that the power should later be created or conferred.

The power to alter, amend, revoke, or terminate will be considered to have existed on the date of the decedent's death, though the exercise of the power was subject to a precedent giving of notice, or though the alteration, amendment, revocation, or termination would take effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice had been given or the power had been exercised, or though the exercise of the power was restricted to a particular time or the happening of a particular event which had not arrived or occurred at decedent's death. When determining the value of the gross estate in such cases the full value of the property transferred subject to the power should be discounted for the period required to elapse between the date of decedent's death and the date upon which the alteration, amendment, revocation, or termination could take effect. (See article 10 (i) (3)).

* * * * *

ART. 25. TAXABLE INSURANCE.—The statute provides for the inclusion in the gross estate of insurance taken out by the decedent upon his own life, as follows: (a) All insurance receivable by, or for the benefit of, the estate; (b) all other insurance to the extent that it exceeds in the aggregate $40,000.

The term "insurance" refers to life insurance of every description, including death benefits paid by fraternal beneficial societies, operating under the lodge system. Insurance is considered to have been taken out by the decedent, whether or not he made the application, if he acquired the ownership of, or any legal incident thereof in, the policy; but

in the case of a decedent dying before November 7, 1934 (the date of approval of the 1934 edition of Regulations 80), the provisions of the second paragraph of article 25 of Regulations 70 (1929 edition) will continue to apply. Legal incidents of ownership in the policy include, for example: The right of the insured or his estate to its economic benefits, the power to change the beneficiary, to surrender or cancel the policy, to assign it, to revoke an assignment, to pledge it for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc.

* * * * * *

ART. 27. INSURANCE RECEIVABLE BY OTHER BENEFICIARIES.—The statute requires the inclusion in the gross estate of the decedent of the proceeds of any policy, or the aggregate proceeds of all policies, not receivable by or for the benefit of decedent's estate, to the extent that such proceeds exceed $40,000, regardless of when the policy was or the policies were issued, if the decedent possessed at the time of his death any of the legal incidents of ownership.

The estate is entitled to only one exemption of $40,000 upon insurance receivable by beneficiaries other than the estate. For example, if the decedent left life insurance payable to three such beneficiaries in amounts of $10,000, $40,000, and $50,000 (total, $100,000), the full amount should be listed on the return and therefrom subtracted the $40,000 exemption as provided in the appropriate schedule of Form 706. The word "beneficiaries", as used in reference to the $40,000 exemption, means persons entitled to the actual enjoyment of the insurance money.

U. S. GOVERNMENT PRINTING OFFICE: 1940